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# Of Czechoslovakia and Ourselves: Essential Legal Supports for a Free Market Economy

By RICHARD S. GRUNER\*

## I. INTRODUCTION

Across Eastern Europe, countries are struggling to overcome economic stagnation and to compete for western capital and markets. In Czechoslovakia, the Government plans to restore some of that nation's former industrial success<sup>1</sup> by establishing a new legal framework for economic activities.<sup>2</sup> Drastic revisions in commercial and property laws have already been implemented to expand foreign capital investment, increase entrepreneurial incentives based on private ownership of most businesses, and bring about new efficiency in Czechoslovak business enterprises. The Czechoslovak Government's emphasis on legal reforms as essential steps towards economic renewal reflects an underlying belief that a rule of law can create greater incentives to investment and entrepreneurial activities than the country's past regime of uncertain state economic controls.<sup>3</sup>

What is striking about the legal reforms now underway is how ex-

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1. Czechoslovakia received 70-80% of the industrial facilities of the former Austro-Hungarian empire at the close of World War I. A period of political stability and economic prosperity ensued; at the beginning of World War II, Czechoslovakia was one of the world's ten most industrialized states. U.S. DEP'T OF THE ARMY, *CZECHOSLOVAKIA: A COUNTRY STUDY* 32 (Ihor Gawdiak ed., 3d ed. 1989) [hereinafter *CZECHOSLOVAKIA*].

2. Czechoslovakia needs to promote economic progress by "bring[ing] its legal framework into line with the norms of a market economy so that property rights and contracts can be asserted and defended." Edward Fennell, *English Join the East's Velvet Revolution*, *THE TIMES*, July 2, 1991, at 29.

3. Czechoslovakia's President Vaclav Havel recognized the importance of a firm legal foundation for a strong Czechoslovak economy when, in response to a question about whether it was time to privatize Czechoslovakia's economy, Havel observed: "Right now we are in a transitional stage, where individual businesses are acting as though they were private, but without legal standing. The law must be articulated before we proceed." Lawrence E. Joseph, *Prague's Spring Into Capitalism*, *N.Y. TIMES*, Dec. 2, 1990, § 6 (Magazine), pt. 2, at 20, 34.

tensive they will be. The State has owned almost all property in Czechoslovakia since widespread nationalization of private property by the Communist Government in the late 1940s. As one top Government official remarked, "You can't understand the scope of the challenge and opportunity until you realize that here we don't own anything other than our toothbrushes."<sup>4</sup> Czechoslovak legal reformers must begin to define new property interests and associated commercial standards almost from scratch.

This Article examines the Czechoslovak Government's initial steps towards these ambitious goals, as well some of its future plans. It compares Czechoslovakia's new business laws with their American counterparts. While American commercial and property laws are neither flawless nor the exclusive means of promoting a free market system, a comparison to evolving Czechoslovak standards is worthwhile for several reasons. First, American legal standards provide a working, tested benchmark for predicting future problems with new standards governing commercial environments elsewhere.<sup>5</sup> Second, and perhaps more significant to economic reform, similarities between American and Czechoslovak commercial and investment laws may influence American business executives' decisions to undertake foreign investment or joint ventures in Czechoslovakia. Finally, as a crucial part of ambitious efforts to design an entire commercial law system, Czechoslovakia's new legal standards provide a concrete statement by a highly interested set of reformers about the necessary components of a modern commercial law system. This statement, in turn, may help us understand which American legal constructs form the essential core of a free market system.

Part II of this Article describes the background of the Czechoslovak Government's commercial law reforms. Part III then analyzes the reforms already instituted, including the new joint-stock companies code, foreign investment statutes, and foreign trade law. Part IV examines pending reforms, most notably further privatization schemes. Finally, Part V discusses the necessity of an independent and principled Czechoslovak judiciary to effect economic reform.

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4. *Czech, Hungarian Trade Surges; Mission Planned*, CRAIN'S N.Y. BUS., May 14, 1990, at 47.

5. The Czechoslovaks themselves have not missed the lessons that can be drawn from the success of the American economy. As Minister of Economics Vladimir Dlouhy remarked, "We now look to the United States for entrepreneurial spirit, aggressiveness, hard work, and the willingness to take risks." Joseph, *supra* note 3, at 34. They are also looking to American law as a possible model for new legal standards. See Robert Abrams, *Our Constitutional System a Model for Emerging European Democracies*, N.Y. L.J., May 1, 1991, at 38.

## II. FORCES COMPELLING CHANGE

Following the toppling of Czechoslovakia's Communist Government in the winter of 1990, the new Government implemented initial legal reforms rapidly, propelled both by principle and necessity. In part, these early changes reflected new doctrinal beliefs. Top Czechoslovak officials viewed free market forces as resource allocation mechanisms preferable to the bureaucratic controls that produced technological stagnation and poor productivity under the prior Communist Government.<sup>6</sup> A more important motivation for the recent changes, however, was undoubtedly fear—fear about the domestic consequences of economic isolation from western commerce as many former suppliers and markets in the Communist block disappeared.<sup>7</sup>

A number of developments in the past year have combined to increase this fear and to encourage the fastest possible reforms. One source of pressure is competition among Eastern European countries simultaneously trying to attract greater foreign investment and western capital. Countries that are most attractive to western companies and investors in the early stages of this competition stand to gain the most by establishing economic relationships that may be difficult to obtain once the current business interest in Eastern Europe cools.<sup>8</sup>

As several Eastern European countries compete with Czechoslovakia for investment dollars, those same countries, along with the Soviet Union, are importing fewer Czechoslovak goods.<sup>9</sup> Before the winter of 1990, East Germany and the Soviet Union were the primary purchasers of Czechoslovak exports. However, consumers in former East German territory presumably will look to domestic German sources for similar

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6. Czechoslovak Finance Minister Vaclav Klaus states these concerns in no uncertain terms: "We have an irrational, wasteful, nonfunctioning centrally planned economy. The transition to a free-market system must be radical, immediate and irrevocable." Joseph, *supra* note 3, at 22.

7. See *id.*; Glenn Frankel, *Czechs Head West to Pitch Privatization of Industries*, WASH. POST, June 14, 1991, at A23.

8. Czechoslovakia possesses some distinct strengths in its race to revitalize its economy. For example, Czechoslovakia has little foreign debt (totalling \$7.5 billion at the end of 1990) and no domestic debt. Nevertheless, offsetting problems exist: prior to recent reforms, all of its industry and trade except agriculture were state-owned, prices were distorted, and energy costs were highly subsidized through arrangements with the Soviet Union. See *Czechoslovakia Needs Foreign Capital and Know-How*, Finance Official Says, 8 Int. Trade Rep. (BNA) 444 (Mar. 20, 1991).

9. Czechoslovak "[i]mports from COMECON countries fell by 9.7% in the first quarter of 1990, and exports fell by 19%. Exports to Western countries also fell by 3.7% during this period, but imports from the West increased by approximately 15%." See IBC USA Licensing Inc., *Country Report: Czechoslovakia*, December 1, 1990, available in LEXIS, World Library, Busanl File, at \*3 [hereinafter *Country Report*].

goods after reunification<sup>10</sup> and the Soviet Union may be hard pressed to pay for future imports.<sup>11</sup> Thus, Czechoslovak businesses need to substitute new western markets and production relationships for commercial ties that no longer exist.

Strong pressure for more hard currency also propels Czechoslovak legal reforms encouraging foreign investment and sales. While hard currency would aid in a number of economic reforms, perhaps the most pressing need is for hard currency to purchase oil supplies. Reduced supplies from the Soviet Union combined with the United Nations embargo of anticipated supplier Iraq resulted in a severe shortage of crude oil.<sup>12</sup> With little hard currency to purchase replacement supplies, industrial activities depending upon oil have been scaled back, and the country endured a dangerous shortage of heating oil during the winter of 1990-91. High per capita energy consumption is also a problem.<sup>13</sup> Given the unhappy coincidence of reduced oil availability from both the Soviet Union and Iraq, Czechoslovak Finance Minister Vaclav Klaus believes that the Government's main strategy must be "to accelerate the reform process, not to postpone it."<sup>14</sup>

Because increased western investment and commercial relationships

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10. Residents of former East German territory are turning to West German products with great enthusiasm. See, e.g., Andrew Fisher, *A Powerful Impetus*, FIN. TIMES, Sept. 11, 1991, Fin. Times Survey, at II (describing the growth of West German automobile sales and manufacturing in former East German regions following reunification). East German adoption of the West German mark in July 1990 also disrupted the ability of East German concerns to pay for imports from Czechoslovakia. See Jonathan Lynn, *Czechoslovakia Points Trade West, Reluctant to Cut Soviet Ties*, The Reuters Lib. Rep., Sept. 20, 1990, available in LEXIS, Nexis Library, Lbyrpt File.

11. Soviet supplies of western currency—necessary for the Soviet Union to make purchases in international markets—have depended heavily on oil and other energy exports. Oil output fell by 6% in 1990 and may drop another 20% in 1991 due to labor unrest and antiquated equipment. Carol J. Williams, *Yeltsin Takes New Powers in Federation*, L.A. TIMES, Sept. 13, 1991, at A1. The recent assertion of control over Russian oil facilities by the Russian Federation further clouds the ability of the Soviet Government to continue past purchasing practices.

Even as they look increasingly towards western markets as the likely source of economic renewal, Czechoslovak officials have not completely given up hope for greater trading with the Soviet Union in the future. As Deputy Foreign Trade Minister Zdenek Cerveny recently observed, "It would be short-sighted to abandon the Soviet market when some of the world's leading potential powers are making great efforts to get a share of it." Lynn, *supra* note 10, at \*2.

12. See Peter S. Green, *Gulf Crisis Tightens Screws on Czechoslovak Economic Reform*, UPI, Sept. 19, 1990, available in LEXIS, Nexis Library, UPI File.

13. *E. Europe Energy Faces Transition Problems*, OIL & GAS J., Aug. 19, 1991, at 22.

14. *Czechoslovakia Seeking IMF Loan to Smooth Transition to Market Economy*, Daily Rep. for Executives (BNA) (Sept. 21, 1990), available in LEXIS, Nexis Library, Drexec File, at \*4.

are probably essential to a successful revival of the Czechoslovak economy, one goal of the legal changes underway in Czechoslovakia appears to be the creation of a commercial system and investment climate which mirrors successful western business practices and which will be correspondingly attractive to western investors and traders.<sup>15</sup> In short, Czechoslovakia is using legal reforms to recast its economy in a western mold, both to attract western investors and to achieve the commercial efficiencies and prosperity Czechoslovaks see in western economies and desire for themselves.

### III. REFORMS ACCOMPLISHED

#### A. Thinking Big: A New Corporations Code

One measure of the government's high hopes for large-scale business activity in the restructured Czechoslovak economy is reflected in its adoption of the equivalent of a new corporations code, the Joint-Stock Companies Act (the Act), as one of its first legal reforms. The Act revives the Czechoslovak joint-stock company, a form of business ownership that virtually disappeared from the Czechoslovak economy with the nationalization of most businesses in the late 1940s and early 1950s.<sup>16</sup> More than just an association pooling investors' assets,<sup>17</sup> joint-stock companies formed under the new Act will have all of the key attributes of American corporations including: the power to take, hold, and convey property in the company name; the power to sue and be sued in the company name; centralized management; readily transferable ownership interests; perpetual existence; and limited liability.<sup>18</sup>

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15. Thus far Czechoslovak concerns have been remarkably unsuccessful in establishing trade with American counterparts. A recent report lamented the \$150 million of two-way trade between the United States and Czechoslovakia in 1989 as "pathetically low." The same report questioned whether American businesses were giving Czechoslovak business opportunities the same close scrutiny as businesses in Austria, Germany, and Italy, which have already formed initial business partnerships with several about-to-be-privatized enterprises. See *Report Urges U.S. to Step Up Efforts to Promote Trade With Czechoslovakia*, 8 Int. Trade Rep. (BNA) 360 (Mar. 6, 1991).

16. Following the end of World War II, Communist officials nationalized the medium- and large-scale Czechoslovak concerns previously owned through joint-stock companies. In 1948, the Communist Government took control of enterprises with more than 50 employees. See CZECHOSLOVAKIA, *supra* note 1, at 58.

17. Because they are separate legal entities capable of holding property and taking other actions in their own name, the new Czechoslovak joint-stock companies are distinguishable from the "joint-stock associations" lacking these powers which may be formed in some American jurisdictions. See HARRY G. HENN & JOHN R. ALEXANDER, *LAW OF CORPORATIONS* 109-117 (3d ed. 1983).

18. These are indicia that a business enterprise is a corporate equivalent in circumstances where the enterprise is not formally constituted as a corporation. See *id.* at 147-49.

Joint-stock companies are expected to promote Czechoslovak economic reforms in three ways. First, they will provide a simple means of distributing private ownership of large enterprises now held by the State. Once a private company is formed, the State may sell a state-owned enterprise to the company which subsequently will operate like any business. Second, companies formed under the Act will serve, like corporations elsewhere, as vehicles for large scale investment and production, permitting pursuit of business projects on an otherwise unattainable scale. Third, joint-stock companies will facilitate foreign investment by permitting partial or complete ownership of a Czechoslovak company by foreign investors.<sup>19</sup>

Under the Act, no permission from the state is required for either an individual or a juristic person (e.g., another joint-stock company) to form a new company. A joint-stock company may wield broad powers in carrying out "entrepreneurial activities,"<sup>20</sup> being authorized to own property, acquire rights, and assume obligations as a party separate from its shareholders.<sup>21</sup>

The minimum capitalization of a joint-stock company is 100,000 Cz crowns—about 3,000 US dollars at current exchange rates.<sup>22</sup> Each share must correspond to at least 1,000 Cz crowns or about thirty dollars of investment,<sup>23</sup> although more than one party may own a single share as long as the parties act through a single representative.<sup>24</sup> Once formed, the company must maintain a reserve fund of at least 10 percent of its capital.<sup>25</sup>

Ownership of a share in a joint-stock company gives the holder three types of rights: a claim for dividends to the extent that dividends are declared at the annual meeting of shareholders,<sup>26</sup> a right to partici-

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19. See *infra* text accompanying notes 59-93.

20. Joint-Stock Companies Act, art. 1, § 1 (1990) (Czech.), reprinted in CZECHOSLOVAK CHAMBER OF COMMERCE, ACTS ON ECONOMIC RELATIONS WITH FOREIGN COUNTRIES, ON THE ENTERPRISE WITH FOREIGN PARTICIPATION, AND ON THE JOINT STOCK COMPANIES, 57 (1990) [hereinafter ACTS].

21. *Id.* art. 1, § 2; art. 2, § 1 (relief of shareholders of liability for their company's obligations).

22. *Id.* art. 16, § 1. Of the required 100,000 Cz crowns capitalization, a minimum of 50,000 Cz crowns must be paid in when the firm is established. *Id.* art. 16, § 2. The official rate of exchange as of May 24, 1991 was 30 Cz crowns to the U.S. dollar. *Foreign Companies Hesitant To Invest in Czechoslovakia*, CTK Nat'l News Wire, May 24, 1991, available in LEXIS, Nexis Library, CTK File, at \*2.

23. Joint-Stock Companies Act, art. 5, *supra* note 20.

24. *Id.* art. 14, § 1.

25. *Id.* art. 84.

26. *Id.* art. 31, § 1.

pate in the management of the firm (primarily at general meetings of the shareholders held at least annually),<sup>27</sup> and a claim for a fraction of the company's remaining assets following liquidation.<sup>28</sup> Shareholder interests are protected by provisions in the Act addressing mandatory information disclosures in advance of a general meeting,<sup>29</sup> rules governing proxies,<sup>30</sup> and procedures for conducting general shareholder meetings.<sup>31</sup>

The Act authorizes several categories of shares. In addition to regular shares with full voting powers and dividend rights,<sup>32</sup> a company may issue "priority shares," which give their owners priority over owners of regular shares in dividend payments.<sup>33</sup> Companies may reduce or eliminate shareholder voting rights for such shares.<sup>34</sup> The Act also authorizes the sale of staff shares to company employees at special prices.<sup>35</sup> Only active or retired employees of the company may hold these shares and the shares must be repurchased by the company in the event of the holder's death or the end of employment. Interest-bearing shares are also recognized as a means to give parties forming a company a source of low-risk return in addition to dividends.<sup>36</sup> Finally, the Act authorizes companies to issue interest-bearing certificates, which may involve liens on company property to secure interest payments or the right to ask for a company share or for an option to buy a share.<sup>37</sup>

The primary management body for a company formed under the Act is a board of directors elected by the shareholders.<sup>38</sup> The powers of the board may be limited in the company's statutes (i.e., its charter), and board members are jointly and severally liable for acts beyond limitations stated in the statutes.<sup>39</sup> The Act bars board members from making business deals with the company in their own names or being an active participant or senior officer in any other company operating in a similar

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27. *Id.* art. 33, § 1.

28. *Id.* art. 31, § 2.

29. *Id.* art. 33, § 2.

30. *Id.* art. 36.

31. *Id.* art. 39.

32. *Id.* art. 3.

33. Where company resources are inadequate to cover both types of payments, regular shareholders will bear the shortfall.

34. Joint-Stock Companies Act, art. 8, *supra* note 20.

As with preferred stock in many American corporations, priority shares in Czechoslovak companies may be tailored to give investors relatively certain dividends while leaving full voting power and control over company management with regular shareholders.

35. *Id.* art. 9.

36. *Id.* art. 10.

37. *Id.* art. 11.

38. *Id.* art. 50.

39. *Id.* art. 51.



sphere of business.<sup>40</sup> When a board member violates these restrictions, the company may claim damages, demand that the company obtain the business opportunity improperly claimed by the board member, or require that the board member disgorge the profits from such an opportunity to the company.

A second "supervisory board" monitors the board of directors.<sup>41</sup> In most companies, members of the supervisory board are selected by the shareholders and may not be company employees. However, where a company employs more than two hundred workers in full-time jobs, one-third of the members of the supervisory board must be elected by company employees from among their ranks. Members of the supervisory board are entitled to oversee actions taken on behalf of the company by the board of directors and other company officials.<sup>42</sup> Supervisory board members may inspect accounting documents and company books at any time. If a company has an internal inspection organ, such as an internal auditing staff, it will report directly to the supervisory board.<sup>43</sup> Should the company litigate against its directors, the supervisory board represents the company.<sup>44</sup>

Other portions of the Act provide detailed rules for forming a joint-stock company,<sup>45</sup> increasing or decreasing its stated capital,<sup>46</sup> and winding up its affairs.<sup>47</sup>

Many of the above features of Czechoslovak joint-stock companies will be familiar to American lawyers and investors. The powers afforded these companies to acquire rights and hold property mirror similar powers of American corporations.<sup>48</sup> The range of shareholder property and voting rights allowed in a joint-stock company and the ability to limit those rights in a charter parallel similar provisions for American corporations under state codes.<sup>49</sup> Similarly, provisions authorizing firms to is-

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40. *Id.* art. 54.

41. *Id.* art. 55.

42. *Id.* art. 56.

43. *Id.* art. 59, § 2.

44. *Id.* art. 58, § 2.

45. *Id.* arts. 15-27.

46. *Id.* arts. 64-83.

47. *Id.* arts. 85-87.

48. Under American law, corporations can hold property and acquire rights in commercial transactions to the same extent as individuals. These powers follow from the treatment of corporations as fictitious persons under most commercial law standards. See HENN & ALEXANDER, *supra* note 17, at 149-52.

49. Shareholders in American corporations, like their counterparts in Czechoslovak joint-stock companies, typically hold rights to receive corporate dividends, voting power over key corporate decisions, and rights to distributed corporate property upon liquidation, although

sue multiple classes of stock with different voting rights and investment risks are common features of American corporations codes.<sup>50</sup>

Like the new Czechoslovak Act, American corporations codes require centralized management of corporations by or under the direction of a board of directors.<sup>51</sup> Most such codes and the common law decisions interpreting those codes impose duties on corporate directors like those under the new Czechoslovak Act. These duties under American legal standards include obligations to avoid self-dealing<sup>52</sup> and to avoid the usurpation of corporate business opportunities to the directors' private economic advantage.<sup>53</sup> Finally, again in parallel to the new Czechoslovak Act, the duty of corporate directors to conduct the business of their firms within limits defined in their corporations' charters is firmly established under American law.<sup>54</sup>

On the whole, the new Act anticipates many key issues surrounding joint business ownership. For example, it responds to some problems, like self-dealing by board members<sup>55</sup> and weak oversight of board activities,<sup>56</sup> that have plagued American firms in the past several decades. A framework for defining shareholder economic and voting interests is

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any of these may be constrained for a particular class of stock if so provided in the corporate charter. *E.g.*, DEL. CODE ANN. tit. 8, §§ 102(b)(1), 170, 211(b), 281 (1984).

50. All American jurisdictions permit firms to issue two or more classes of stock with the relative investment risks and voting power of each class defined through charter provisions. Typically, these charter provisions specify the sequence and scope of claims for dividends and net assets upon liquidation held by holders of each class of stock and the extent, if any, of their voting powers in corporate governance. *See* HENN & ALEXANDER, *supra* note 17, at 285-94.

51. *E.g.*, DEL. CODE ANN. tit. 8, § 141(a).

52. Under the leading American standard, corporate directors must avoid transactions between themselves and their firms that are either undertaken in bad faith or are so economically unfavorable to their firms that disinterested directors would not approve them. An interested director bears the burden of proving that her transactions with her corporation meet these tests. *See, e.g.*, *Johnston v. Greene*, 35 Del. Ch. 479, 121 A.2d 919 (Sup. Ct. 1956).

53. It is a well established principle of American corporate law that corporate fiduciaries, including corporate directors and officers, are barred from personal gain achieved by diverting to themselves business opportunities which fairly belong to their corporations. Where this occurs, the offending party is usually required to disgorge any related profits to his corporation. *See* HENN & ALEXANDER, *supra* note 17, at 632-37.

54. Under American standards, directors who act in contravention of limitations on their powers in corporate charters can be held personally liable for resulting corporate damage. *See* DEL. CODE ANN. tit. 8, § 124(2); HENN & ALEXANDER, *supra* note 17, at 620-21.

55. Self-dealing by board members and other corporate officials is a common breach of the fiduciary obligations of these parties under American standards. *See* HENN & ALEXANDER, *supra* note 17, at 625-44.

56. Due to imperfect information about board activities, shareholders in large American concerns are often unable to detect and react to actions by corporate directors which are detrimental to shareholder interests. *See* CHRISTOPHER STONE, *WHERE THE LAW ENDS* 80-87 (1975).

clearly set forth, as are the powers and limitations on company directors. The one feature of the Act most different from American corporation laws (although similar to some European standards)<sup>57</sup> is its provision for a supervisory board with plenary oversight powers and, in the case of large firms, a guaranteed minority of employee members. Despite some differences in management style and controversies that may flow from this two-tiered board system,<sup>58</sup> joint-stock companies formed under the new Act have the potential to be as useful as their American corporate counterparts for group investment and business activity.

Provided that the Act is enforced as written—that is, without strained interpretations reflecting an anti-property bent—it is a key step towards both the privatization of Czechoslovak industries and the creation of new private enterprises based on group investments. It recognizes both the need for private ownership of group enterprises (with associated profit potential) and the importance of large scale enterprises in a revitalized Czechoslovak economy.

## **B. Promoting Foreign Investment: Past Mistakes Avoided and Repeated**

Even before the Communist Government was ousted in the winter of 1990, Czechoslovak authorities were making halting steps towards improving the legal environment for foreign investment.<sup>59</sup> Unfortunately, these early measures created several impediments to investment and were largely unsuccessful in attracting foreign business partners.

The Government issued its first law concerning joint ventures between Czechoslovak and foreign investors in 1985. It barred majority ownership of Czechoslovak enterprises by foreign investors and required that each joint venture with foreign investors be approved by five different government agencies. Because of the awkwardness of the procedure, only a few joint ventures were formed.

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57. A similar split of management authority between managing and supervising boards is required under German marketable share company law and allowed under French marketable share company law. See ALFRED T. CONARD, *CORPORATIONS IN PERSPECTIVE* 331-32 (1976).

58. One difference between the two board company of the sort now authorized under Czechoslovak law and a traditional American firm is that the board in the latter exercises powers that are split among two boards in the former. To the extent that members of the two boards differ in business philosophy or objectives, the potential for conflict within the two board firm will be greater. See *id.*

59. Czechoslovakia's progress towards liberalized foreign investment laws before the fall of the Communist Government is described in Martin Radvan, *Want to Do Business in Czechoslovakia*, N.Y. L.J., Dec. 26, 1989, at 1.

A more liberalized foreign investment statute was passed in 1989.<sup>60</sup> This statute removed the restriction on foreign ownership of majority business interests, although some Czechoslovak ownership was still required. Additionally, government approvals were limited to one agency. By October 1989, approximately fifty joint ventures had been organized in Czechoslovakia, thirty-two of them with concerns from non-socialist states.<sup>61</sup> Many of these joint ventures were aimed at the construction and operation of hotels in Czechoslovakia. Most involved West German and Austrian businesses; according to the Commerce Department and the U.S. Embassy staff in Prague, no joint ventures with U.S. concerns were formed prior to the fall of the Communist Government.<sup>62</sup>

These older laws illustrate the uselessness of encouraging foreign investment half-heartedly. They also point to the types of legal restrictions on foreign partnerships which the Czechoslovak government should avoid in its new reforms.

Recognizing the failure of the country's initial joint venture laws, the new Czechoslovak Government passed a revised Enterprise with Foreign Property Participation Act governing foreign investment in Czechoslovak enterprises. Under the new Act, foreign owned enterprises can be established in all branches of the economy, except those affecting national defense and security.<sup>63</sup> The Act permits foreign investment in a variety of forms, including joint-stock companies with either partial or complete foreign ownership, general partnerships, and limited partnerships.<sup>64</sup>

One change from prior law is that individual Czechoslovak citizens are now authorized to take part in joint ventures with foreign investors on the same footing as Czechoslovak corporations.<sup>65</sup> The new provision may aid in the formation of small scale business partnerships between foreigners and individual Czechoslovak entrepreneurs; prior law practically excluded these entrepreneurs from establishing joint ventures with foreigners.

The new legislation also permits a foreign investor to establish either a partially or wholly owned subsidiary in Czechoslovakia.<sup>66</sup> This arrangement should be useful to international corporations wishing to pur-

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60. Enterprise with Foreign Property Participation Act (Act No. 173/1988) (amended 1990) (Czech.), reprinted in ACTS, *supra* note 20, at 40.

61. U.S. Dep't of Com., 1990 *Economic Trends Report—Czechoslovakia* Jan. 1990, at 10.

62. *Id.*

63. Enterprise with Foreign Property Participation Act, art. 7, § 2, *supra* note 60.

64. *See id.* art. 3.

65. *Id.* art. 2, § 3.

66. *Id.* art. 2, § 2.

sue commercial projects in Czechoslovakia while maintaining exclusive or shared control. American firms commonly use wholly owned subsidiaries for doing business in foreign environments.<sup>67</sup>

The procedures required to establish foreign ownership of a Czechoslovak enterprise are streamlined in comparison with prior law but nonetheless may deter some investment. As a vestige of Czechoslovakia's prior planned economy, the Federal Ministry of Finance, or the State Bank of Czechoslovakia in the case of banking businesses, will control the entry of foreign investment into various portions of the economy.<sup>68</sup> An application to make a new foreign investment in a Czechoslovak enterprise must describe the owners of the proposed enterprise and its planned business, the agreement, charter, and by-laws establishing the enterprise, and the degree to which foreign owners will participate in the enterprise's operation. The Act mandates a response to such an application within 60 days of receipt. In reviewing the application, the Ministry of Finance must determine:

whether there is hope that the enterprise being established will contribute to the increase of fruitful participation of the Czechoslovak economy in the international division of labor and whether during its economic activity will be able to create sufficient financial resources both in Czechoslovak as well as in foreign currencies.<sup>69</sup>

Some further restrictions apply to the financial affairs of approved enterprises. For instance, foreign investment enterprises are required to establish a capital reserve fund of not less than ten percent of their capital.<sup>70</sup> This fund need not be set aside at the creation of the enterprise. However, if the fund is not set aside initially, it must be accumulated by payments of not less than five percent of distributable profits of the enterprise each year until the reserve amount is attained.<sup>71</sup>

Aside from the creation of this reserve, the repatriation<sup>72</sup> of profits from a Czechoslovak enterprise is unrestricted, except that such repa-

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67. The primary reason many firms adopt this form of international enterprise is that the foreign profits of a foreign subsidiary will escape U.S. taxation until they are paid to the U.S. parent corporation as dividends. See Scott P. Borsack, Note, *Choosing to Do Business Through a Foreign Branch or a Foreign Subsidiary: A Tax Analysis*, 19 CASE W. RES. J. INT'L L. 393 (1987).

68. Enterprise with Foreign Property Participation Act, art. 5, *supra* note 60.

69. *Id.* art. 7, § 1.

70. *Id.* art. 12.

71. *Id.* art. 12.

72. Repatriation—the transfer of business profits back to the home country of foreign investors—usually occurs through payment of dividends to the investors or to a foreign parent company.

triation must be made in foreign currencies.<sup>73</sup> Unfortunately, this requirement constitutes an indirect restriction on repatriation because mechanisms for foreign exchange presently are limited. Although companies—but not individuals—can now freely convert the Czechoslovak crown to foreign currencies within Czechoslovakia,<sup>74</sup> the Act specifies that the conversion must be at rates fixed by the Czechoslovak State Bank.<sup>75</sup> It also requires that such an enterprise can open foreign exchange accounts with foreign banks only if approved by the State Bank.<sup>76</sup> The possibility that the State Bank will use control over currency exchange by foreign investment enterprises to impede the repatriation of dividends continues to raise doubts among potential investors and is a significant deterrent to further investment.<sup>77</sup>

Under the new statute, joint ventures involving foreign ownership pay the same taxes as domestic enterprises. A forty percent income tax applies to joint ventures with thirty or more employees. There is also a twenty-five percent tax on repatriated interest and dividends. However, tax exemptions of up to two years may be approved.<sup>78</sup>

Early results in attracting new foreign investment under the new Czechoslovak standards have been poor. As of the end of 1990, Czechoslovakia had licensed more than 1,230 joint ventures involving foreign investment, of which about twenty percent were wholly owned by westerners.<sup>79</sup> The largest sources of foreign investment were Austria, West

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73. Enterprise with Foreign Property Participation Act, art. 20, § 2, *supra* note 60.

74. The crown was made internally convertible within Czechoslovakia on January 1, 1991, making western currency available to buy foreign products. See Shelley Galbraith, *Czechoslovakia: U.S. Commercial Relations are Clearly on the Upswing*, BUS. AM., Apr. 22, 1991, at 37. However, individuals may only exchange a small amount of currency, thereby limiting the possible use of foreign currencies as a substitute for the crown in domestic transactions involving individuals.

75. Enterprise with Foreign Property Participation Act, art. 17, *supra* note 60.

76. *Id.*

77. See Mary Brasier, *Czechoslovakia: The Snags in Making Your Money Go West*, LONDON DAILY TELEGRAPH, Apr. 22, 1991, at 27. Czechoslovak officials seem sensitive to the significance of this problem as a deterrent to foreign investment. In October of 1991, during a visit to Washington, Czechoslovak President Vaclav Havel signed a bilateral trade agreement which guarantees that U.S. investors will be able to freely repatriate profits from foreign investments in Czechoslovakia. However, Czechoslovak officials have yet to articulate how these assurances will be carried out within the currency exchange system. See Michael Wines, *Havel Appeals for U.S. Investment and Markets in Talks with Bush*, N.Y. TIMES, Oct. 23, 1991, at A5.

78. See *The Czech's Potential Liberalisation*, FIN. TIMES, May 1990, available in LEXIS, Nexis Library, Fintme File.

79. *Czechoslovakia Proposes to Ease Foreign Investment Licensing Rules*, Daily Rep. For Executives (BNA), at A-4 (Jan. 17, 1991), available in LEXIS, Nexis Library, Drexec File, at \*3.

Germany, Switzerland, Italy, and France.<sup>80</sup> However, most of these joint ventures were small enterprises with capitalizations of 10,000 dollars or less.<sup>81</sup> The overall capitalization of all foreign investment enterprises was less than ten million dollars.<sup>82</sup>

Perhaps because of the limited success of the present rules, the Czechoslovak Finance Ministry has proposed relaxing approval requirements for foreign investors.<sup>83</sup> Under this proposal, western investors would no longer need the Ministry's approval for joint enterprises not involving a Czechoslovak company.<sup>84</sup> Joint enterprises with Czechoslovak nationals, however, would still be subject to Finance Ministry approval.<sup>85</sup>

While a number of issues can only be clarified through a history of enforcement, the new Czechoslovak statutory provisions for foreign investment generally give foreign investors a legally equivalent position to their Czechoslovak counterparts in the ownership or co-ownership of Czechoslovak enterprises. This equal status will tend to lend confidence to Americans considering Czechoslovak projects. The two exceptions to this favorable tone are the remaining state control over approval of enterprises in various sectors—a scheme presumably aimed at limiting foreign competition in the most lucrative economic sectors like tourism—and restrictions on profit repatriation due to limited foreign exchange mechanisms.<sup>86</sup>

### C. Foreign Trade: Vestiges of a Controlled Economy

The third and perhaps weakest of the legal reforms enacted by the Czechoslovak Government in the spring of 1990 is the new Act on Economic Relations with Foreign Countries (Economic Relations Act). The Economic Relations Act establishes a three-tier trade system which is designed to limit some import-export activities while not impairing related domestic production.

For Czechoslovak persons, import and export activities incidental to domestic production may be undertaken merely by registering a descrip-

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80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.* at \*1.

84. *Id.*

85. *See id.*

86. The Czechoslovak government has entered into a bilateral trade agreement guaranteeing U.S. investors the ability to repatriate profits from investments in Czechoslovakia. *See Wines, supra* note 77. Whether these guarantees are translated into a workable exchange process for repatriating profits remains to be seen.

tion of that activity in the Czechoslovak Companies Register.<sup>87</sup> No further authorization is required. A "domestic production" activity for these purposes is one that results in an essential change in the quality and utility of purchased raw materials and further results in a value added in production<sup>88</sup> of at least thirty percent of the cost of raw materials.<sup>89</sup> Thus, raw material imports and processed product exports that are inputs and outputs of Czechoslovak production essentially are unregulated under the Economic Relations Act.

This relatively unrestricted system applies to all juristic persons created under Czechoslovak law, including joint-stock companies. However, where such an entity involves foreign investment and management, the enterprise's creation must be approved by the Federal Ministry of Finance. Thus, in establishing foreign-owned and foreign-controlled enterprises for combined import-export and production purposes, other foreign investment laws indirectly impose regulatory restrictions which the Economic Relations Act avoids.

"Pure" import or export activities by Czechoslovak persons (i.e., those not related to their own production) are more restricted under the Economic Relations Act. Parties must obtain approval for such activities from the Ministry of Finance through an application identifying the parties involved and the nature of the proposed foreign trade activity.<sup>90</sup> This application will be approved if the Czechoslovak applicant shows "that it meets the requirements guaranteeing a due, economically efficient and rational exercise of such activities and disposes of sufficient foreign currency funds to meet its liabilities arising out of a breach, if any, of its obligations towards foreign persons."<sup>91</sup> However, the Economic Relations Act does not specify the means for determining adequate levels of foreign currency or the steps that must be taken to insure its availability to satisfy liabilities.

Foreign parties, including foreign corporations, wishing to conduct import or export activities in Czechoslovakia fall under a different approval scheme. Upon a similar application for approval, the Ministry of Finance will approve foreign trade activities by a foreign person "if such grant appears to be in concordance with the goals of an expedient integration of the Czechoslovak Federative Republic's national economy into

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87. Act on Economic Relations With Foreign Countries (Act No. 42/1980), art. 7, § 2 (amended 1990) (Czech.), *reprinted in* ACTS *supra* note 20, at 7.

88. That is, the sum of direct wages, overhead, direct and distribution costs and profit.

89. Act on Economic Relations with Foreign Countries, art. 7, § 3(a), *supra* note 86.

90. *Id.* art. 7c.

91. *Id.* art. 8, § 1.



the international division of labor."<sup>92</sup> Obviously, this does not define a clear-cut standard.

Persons carrying on foreign trade activities must deposit a security of 20,000 Cz crowns for Czechoslovak natural persons and 100,000 Cz crowns for all others in a Czechoslovak bank.<sup>93</sup> Failure to post or maintain this security is grounds for exclusion from further foreign trade activities, as are actions in excess of a person's authorized activities.<sup>94</sup> Authorization to engage in foreign trade also may be withdrawn where the factual grounds for granting it are no longer present.

Taken as a whole, the approval standards imposed on foreign exporters and importers under the new Economic Relations Act create intimidating barriers to foreign investment. The significance of these barriers is increased by the ambiguity of key standards. For example, in applications to Czechoslovak authorities by foreign traders, what kinds of economic circumstances will support the authorization of foreign trade activities? Even if foreign trading is encouraged in the short term, how much assurance will foreign traders have in the long run that their authorizations will not be withdrawn when government assessments of the strength of domestic traders or industries change? The Economic Relations Act seems to allow the withdrawal of authorizations given to foreign traders when domestic traders grow strong enough to act as substitutes for foreign concerns or when the support of foreign export specialists is no longer needed to bring Czechoslovak goods to foreign markets. It may also allow such authorizations for foreign importers to be withdrawn as a domestic industry strengthens and foreign products pose a competitive threat. Finally, since authorizations are essential to begin activities and, in some cases, are grants of temporary monopolies once they are obtained, significant delays in processing applications could undercut the economic advantages of market entry or artificially protect initial entrants from competition.

The ambiguity of these standards and current uncertainty about how they will be applied probably will inhibit import-export activities by

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92. *Id.*

The Economic Relations Act imposes a separate scheme of trading authorizations for "foreign economic services." See *id.* arts. 17-22. Such services include transportation, communications, cultural, educational, insurance, and medical services provided by a Czechoslovak person to foreign persons or by a foreign person in Czechoslovak territory. In each of these areas, approval of the responsible government agency is necessary to begin activities. In addition, the Act authorizes the relevant agencies to promulgate their own regulations governing foreign economic services in their respective regulatory domains.

93. *Id.* art. 7b, §§ 1, 4.

94. *Id.* art. 8, § 2.

foreign traders. Nevertheless, the Economic Relations Act does streamline incidental import-export trading by Czechoslovak persons engaged in their own production activities. Thus, where domestic entrepreneurs produce goods capable of competing in world markets, these new provisions should aid the producers in bringing such goods to market. Similarly, by encouraging imports destined for further processing by the importer, these new standards may stimulate Czechoslovak enterprises aimed at the reprocessing and resale of foreign goods.

#### IV. FURTHER CHANGES AHEAD

These new enactments by no means exhaust the Government's legal reform agenda. Revisions to the commercial, tax, bankruptcy, and labor codes are pending. New personal property laws and mechanisms for dividing and distributing private ownership of enterprises now controlled by the State are only beginning to be implemented.

Several novel approaches to ownership distribution are being tried. For distribution of large enterprises, the Government has approved a voucher system under which each citizen will receive low-cost point vouchers which may be used to bid for fractional ownership of companies auctioned by the State.<sup>95</sup> In essence, this privatization scheme recognizes the nominal interest of each citizen in every state-owned enterprise, while taking a free market approach to the initial valuation and redistribution of ownership shares.<sup>96</sup> The effectiveness of this scheme will turn on solving the serious administrative and procedural problems which undoubtedly will surround the initial trading process and the later efforts of co-owners to oversee the resulting business enterprises.

For small businesses such as shops and restaurants, auctions to individual buyers are planned. The sale of some 150,000 small businesses is scheduled for 1991.<sup>97</sup> The first auctions took place in late January 1991. As of June 1991, the government had sold off about 3,000 shops and small businesses to private buyers, most of them Czechoslovaks.<sup>98</sup> A fur-

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95. *Czechoslovakia to Denationalize Industry as Latest Step in Economic Reform Program*, 8 Int. Trade Rep., (BNA) 360 (Mar. 6, 1991) [hereinafter *Czechoslovakia to Denationalize Industry*].

96. See generally John Lloyd, *Czechs Pioneer a New Way to Privatise an Entire Economy*, FIN. TIMES, June 1, 1990, at 2; Jonathan Lynn, *Czechoslovakia Pursues Controversial Sale of State Enterprises*, The Reuter Lib. Rep., Dec. 22, 1990, available in LEXIS, Nexis Library, Lbyrpt File.

97. See *Czechoslovakia Needs Foreign Capital and Know-How, Finance Official Says*, 8 Int. Trade Rep. (BNA) 361 (Mar. 20, 1991).

98. Frankel, *supra* note 7.

ther campaign to sell fifty large companies will be next. These companies, which collectively employ 800,000 workers and earn annual incomes of fifty million to 500 million dollars per firm, will be marketed to foreign investors.<sup>99</sup>

An additional law requires the government to return to the original owners property nationalized by the Czechoslovak Communist Government since 1948.<sup>100</sup> These provisions could affect property worth an estimated 300 billion Cz crowns (11 billion U.S. dollars). Difficulties in proving prior ownership have stalled many claims under this legislation and, since property claimed for return cannot be otherwise disposed of until the claim is rejected, have slowed the remainder of the privatization program.

Another possible approach to redistributing State-held ownership interests was used in recent efforts to sell foreign investors partial ownership of the Hotel Praha in Prague. There, the value of the hotel was assessed by independent experts in travel industry properties and a prospectus describing the property was prepared. The Government then solicited bids from various foreign investors for the fractional ownership interests being sold. The similarity of this process to an initial stock offering in an American setting was reinforced by the involvement of both the Bankers Trust bank and the New York law firm of White and Case in preparing the bidding documents.<sup>101</sup> However, the extent to which the Government will use this process in the future is unclear. In practical terms, it may be limited to a few unusually attractive properties like the Hotel Praha, which was built to western standards to house visiting Communist dignitaries and other important visitors and which now promises to play an important role in Prague's expanding tourist trade.

While privatization may be essential to reform in the short run, the extensive attention it has received from both government officials and

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99. *Id.*

100. *Czechoslovakia to Denationalize Industry*, *supra* note 95.

101. See *U.S. Advisors Assist Municipal Government With the Privatization of Prague's Hotel Praha*, PR Newswire, Nov. 19, 1990, available in LEXIS, Nexis Library, Pnews File; cf. Diane Knox, *White & Case's Man In Prague*, AMER. LAW., Mar. 1991, at 22 (describing the expanding involvement of this New York firm in guiding the legal affairs of the Czechoslovak government).

Previously, another team of British specialists including the accounting firm of Ernst and Young; the merchant bankers Schroders; and the law firm of Denton, Hall, Burgin and Warrens advised the Czechoslovak government on property sell-off techniques. This team was subsidized by funds from the British government. See James Hardy, *State Sell-Off Experts Head For Prague*, Press Ass., Sept. 10, 1990, available in LEXIS, Nexis Library, Panews File.

Several London law firms are competing aggressively for work on British-Czechoslovak joint ventures. See Fennell, *supra* note 2.

Czechoslovak citizens may be a mixed blessing. There is a significant danger that current debates about property distribution measures and related questions concerning restitution for previously nationalized properties may distract the Government from completing reforms that are more important in the long run.<sup>102</sup> Even if state-owned businesses are redistributed fairly, the future success of those businesses and of the Czechoslovak economy as a whole still will turn on the creation of an underlying business system, including appropriate property and commercial laws, that encourages entrepreneurial activity and promotes greater foreign investment to increase that activity.<sup>103</sup> Completing fundamental legal changes aimed toward these ends remains the Government's most important legal reform task.

## V. THE IMPORTANCE TO REFORM OF INDEPENDENT COURTS AND GOVERNMENT OBSERVANCE OF THE RULE OF LAW

While its economic and social success still must be proven, legal restructuring is an important step in Czechoslovakia's emergence from Communist rule. Current changes reflect the Government's strong commitment to a new economy and to the rule of law as a means of encouraging stability and progress. The significance of such changes in the development of the Czechoslovak economy now depends on familiarizing domestic and foreign investors with the terms of these statutes and on building confidence in the fairness and effectiveness of the new legal regime as a framework for business enterprise.

The ultimate success of Czechoslovakia's legal "jolt" to the economy will also depend on two additional features of its legal system: first, an active, powerful judiciary capable of interpreting and enforcing these new legal standards and, second, a sufficient respect on the part of Government officials for the rule of law and the importance of evenly applied legal standards to insure that the Government does not undercut the new

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102. The provision of restitution to Czechoslovak citizens for property nationalized by the Communist government in the 1940s and 1950s is proving to be problematic. While a recently enacted restitution law provides a mechanism for some such recoveries, the difficulty of proving former ownership at the time of nationalization suggests that legal battles over restitution may continue for some time. Indeed, Finance Minister Vaclav Klaus doubts that these payments can be made fairly. He noted that "[t]he whole issue of restitution is extremely difficult, perhaps impossible. I don't know if there's an answer. I might almost be inclined to regard Communism as a natural disaster and not give anything back to anybody." Joseph, *supra* note 3, at 34.

103. See generally Michael Schrage, *Eastern Europe's Greatest Need: A New Generation of Entrepreneurs*, WASH. POST, Mar. 29, 1991, at F3.

laws for political reasons. Unfortunately, some recent developments suggest that these essential corollaries to new legal standards may not yet be present in Czechoslovakia.

Even without the additional caseload of new legal controversies arising from private business ownership and from heightened levels of commercial activity, there are clear signs that Czechoslovakia's judiciary is already overburdened. The extent of this problem was revealed in the summer of 1990 when judges in Prague and other parts of Czechoslovakia staged a work slowdown to protest the Government's inadequate provision for new courts.<sup>104</sup> That the judges felt such extreme action was necessary suggests judicial staffing may pose a serious problem that could undercut the significance of the country's new commercial law standards. The Czech Minister of Justice recently described the shortage of judges in his republics as "catastrophic" and called for the appointment of twice the present number of judges to support new commercial and administrative law caseloads.<sup>105</sup>

On a different front, another incident last year revealed that the merits of the rule of law as a barrier to government action may not be fully apparent to top Czechoslovak officials. In discussions with several American journalists, Michael Zantovsky, press secretary to Czechoslovak President Václav Havel, described Government attitudes toward freedom of the press and related issues.<sup>106</sup> As an illustration of Government attitudes, he speculated that were a local journalist to obtain and publish a secret Government list of 140,000 Czechoslovaks who collaborated with the former Communist Government, the Government would arrest and jail the offending journalist.<sup>107</sup> This action would follow despite the Government's reported use of the same information to pressure candidates out of recent elections.<sup>108</sup> Zantovsky's justification for this action was that disclosure of the list would involve serious damage to the reputations of named persons who were either minor supporters of the Communist Government or were duped into their supporting roles.<sup>109</sup>

While these concerns may militate against publishing of some or all

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104. *Judges in the Czech Republic Resume Full Duties*, (Prague Home Service, Jul. 11, 1990), available in LEXIS, Nexis Library, Bbcswb File. After new commitments by the Czech Minister of Justice to pursue rebuilding of the judicial system, the judges returned to work.

105. *Czech and Slovak Ministers Agree on Coordinated Action*, (Radio Czechoslovakia, Aug. 28, 1991, Sept. 3, 1991), available in LEXIS, Nexis Library, Bbcswb File, at \*2.

106. Benjamin C. Bradlee, *The Shock of the Press: In Eastern Europe's New Democracies, Fighting for Free Speech is Easier than Living with it*, WASH. POST, July 15, 1990, at B1.

107. *Id.*

108. *Id.*

109. *Id.*

of this list, once such a list surfaced in public these decisions should be left to newspaper and journal editors, not government officials. A system maintaining government control over such publication decisions risks impairing the freedom of the press to report and comment on government actions.<sup>110</sup> A greater concern, however, is that Zantovsky's comments suggested that the Government would jail the hypothetical offending journalist without any need for a trial to prove that she or he had obtained the lists improperly and that they were published with knowledge that the government had prohibited such disclosure. Faced with a publication that the Government apparently felt would be politically undesirable, the first instinct of Czechoslovak officials, Zantovsky's comments suggest, would be to act punitively without regard for freedom of the press, due process, or the right to a fair trial as barriers to government action. As the Washington Post's Ben Bradlee, one of the journalists present, later commented, Zantovsky appeared to treat freedom of the press and judicial due process as luxuries which government officials might disregard if they felt they had good reason.<sup>111</sup>

Such casual disregard of regular legal process in the thinking of top officials cannot help but give American lawyers and their business clients pause. Taking this lesson outside its original journalistic context, the questions raised for business executives are whether Government discretion in interpreting and applying new commercial laws will be exercised in a similar spirit of political expediency, whether court rulings will be influenced by political whim rather than predictable standards, and whether court rulings disliked by government officials will be disregarded.<sup>112</sup>

While many economies successfully operate under far greater political controls than apply in the United States, the American experience in commercial law, as well as in other legal domains, demonstrates that society benefits where the rule of law is superior to the politically motivated

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110. Freedom of the press is not formally protected under Czechoslovak law and remains threatened by the ambiguous relationship between government officials and the press. See Ian Hargreaves, *A Liberated Press Struggles to Be Free*, FIN. TIMES, Mar. 2, 1991, § 2 (Weekend), at I.

111. See Bradlee, *supra* note 106.

112. In adopting legal reforms, one of the most difficult tasks Czechoslovak officials may face will be creating a powerful judiciary in the face of public suspicion of strong government authority resulting from years of Communist rule and Communist use of the judiciary as puppets to implement Communist policies. As one observer noted, under the old Government, "telephone justice" prevailed. When a case arose, party officials told judges and lawyers what to do. Judges, who were party appointees, served the needs of the party, not the rule of law. Susanne Sternthal, *Lawyers Live Spirit of '87 Revolution In Eastern Europe*, WASH. TIMES, July 4, 1991, at E1.

desires of a particular official or dominant political group. The alternative is a system in which officials wield power over private as well as public activities, with corresponding opportunities for corruption. Even more importantly, given the objectives of current Czechoslovak legal reforms, disregard for the rule of law will produce a commercial system in which uncertainty about the fairness and stability of future legal treatment will create doubts about probable rewards for commercial activities. These doubts will deter both Czechoslovak citizens and outside investors from initiating new entrepreneurial efforts that Czechoslovakia now needs.

## VI. CONCLUSION

Czechoslovakia's recent legal reforms are important first steps toward economic resurgence. The new standards provide viable vehicles for group ownership of Czechoslovak enterprises and put foreign investors on an equal plane with domestic parties in these enterprises. Some serious questions remain, however, about how these standards will be applied. These include what standards will govern the approvals necessary for entry of foreign investors into some portions of the economy and whether the State Bank will conduct exchange activities in ways that hinder repatriation of profits to foreign owners.

Beyond these administrative questions, however, loom doubts about the ability of Czechoslovak judges and government officials to apply the new standards with respect for the rule of law as a barrier to political expediency and with proper time and attention to the merits of particular claims. To make their legal reforms convincing inducements to foreign investment, Czechoslovak officials must follow those reforms with the creation of a new independent judiciary and with a commitment to be bound by the decisions of that judiciary.

Czechoslovakia's remarkable progress in shedding the commercial law standards of its Communist past is an important chapter in its recent history of political and economic reform. Yet, the ultimate importance of its new standards turns on achieving further changes. If, as Government officials have reason to hope, these standards prove to be tools for an independent judiciary to maintain an effective commercial law system, inducements for greater foreign investment and trade, and precursors of greater economic prosperity of Czechoslovak citizens as a consequence of these foreign ties, then the recent legal reforms will indeed be an important milestone in Czechoslovak history.